TERM CORRA OFFICIALLY UNDER DEVELOPMENT

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On January 11, 2023, the Canadian Alternative Reference Rate Working Group ("**CARR**") announced that both a 1- and 3-month Term CORRA benchmark are under development, with a targeted official publication date of end of Q3-2023.[1] Term CORRA will comply with the Principles of Financial Benchmarks developed by the International Organization of Securities Commissions ("**IOSCO Principles**") as well as Canadian benchmark regulations.

The development of the Term CORRA benchmark constitutes an important step in the transition away from the Canadian Dollar Offered Rate ("**CDOR**"), as previously outlined by us here. The transition process began following the publication of a white paper by CARR, which found that the methodology for determining CDOR was inconsistent with evolving global best-practices. These best practices involve developing reference rates through high volumes of observable arm's length transactions, instead of through the use of expert judgement or opinion.

What is Term CORRA?

The need for Term CORRA arises from the difficulty in transitioning from a forward-looking benchmark, such as CDOR, to an overnight rate, such as the Canadian Overnight Repo Rate Average ("**CORRA**"). To create a new, forward-looking term rate, CARR worked with various stakeholders across the financial services industry. Term CORRA is intended to reflect the CORRA overnight index swap rate for both 1- and 3-month periods at a specific point in time.

Term CORRA will be derived from calculations using transactions and executable bids of 1- and 3-month overnight CORRA interest rate futures, traded on the Montreal Exchange.[2]

Of note, CARR has provided a second "level" of methodology to calculate Term CORRA. The existence of this Level 2 methodology highlights potential liquidity challenges that undermine the Term CORRA calculation. If there are insufficient transactions or limit orders in CORRA futures to generate adequate liquidity for a daily Term CORRA calculation, the prior day's Term CORRA rate will be adjusted for any move in historical CORRA rates over a specific tenor to provide the daily rate. The Level 2 methodology may be used for up to 10 days by the administrator after which the administrator needs to re-examine the original methodology to determine how it can be made viable.[3]

Who is the Administrator?

Term CORRA will be produced and managed by CanDeal Innovations Inc. ("**CanDeal**") with TMX Datalinx, subject to regulatory approvals.[4] TMX Datalinx is the information services division of TSX Inc. CanDeal has previously constructed Canadian yield curves as well as published benchmark bond prices that comply with IOSCO Principles. CanDeal will be responsible for all aspects of Term CORRA, including monitoring compliance with Canadian benchmark regulations and IOSCO Principles.

Since Term CORRA will be a designated benchmark, CanDeal and TMX Datalinx will be regulated as designated benchmark administrators by the Ontario Securities Commission and the Autorité des marchés financiers. Such regulation involves, among other things, CanDeal and TMX Datalinx complying with certain governance and internal oversight requirements.

It is noteworthy that a Canadian administrator, as opposed to a large international organization, will manage the benchmark. This is unlike CDOR, whose administrator was Refinitiv Benchmark Services (UK) Limited.

Approved Use Cases for Term CORRA:

CARR notes that many financial products that reference CDOR will transition to the use of overnight CORRA, calculated in arrears.[5] CARR states that predominant use of an overnight rate is consistent with other jurisdictions and aligned with the directions from the Financial Stability Board, Bank of Canada and other international central banks and regulators.

However, some instances may require the use of a forward-looking risk-free rate, such as Term CORRA. CARR has approved three uses of Term CORRA:

- Loan Products
- Trade Finance (Described as the discounting of receivables)
- Single currency derivatives for end-users hedging Term CORRA-based loans, where the end user is the lender, borrower or guarantor under such loans.

In the future, inter-dealer single currency derivative transactions may be added as an approved use for Term CORRA.[6] A decision will be made prior to the benchmark's official publication.

CARR has not approved using Term CORRA for other uses including floating rate notes, securitizations, capital securities, structured notes and derivative uses not explicitly identified as eligible (including cross-currency basis swaps).

A licensing agreement will be required if an entity wishes to use Term CORRA when providing or originating financial products that reference the new benchmark. Use licensing will have a "commercially reasonable" cost. End-users of Term CORRA products do not have a similar license requirement until June 28, 2024. After that date, end-users may have to obtain a license. There is no similar proposal for Term SOFR and end-user licensing seems like it would create a substantial administrative burden with little corresponding benefit.

Although the Canadian licensing regime is still being determined, it may mirror the American regime, which provides two categories of licenses for lenders. In the Unites States, one level of license allows lenders to use Term SOFR derivatives for cash markets, while the second level allows Term SOFR to be used in derivatives markets on a very limited basis.

Fallback Language Implications

While CARR has approved certain uses for Term CORRA, it reiterates that borrowers with the capacity to use overnight CORRA should use it in preference to Term CORRA, especially borrowers who hedge loans using derivatives.[7]

This is contrary to the fallback language for loans referencing CDOR published by CARR in August 2022, which prioritizes Term CORRA as the initial fallback rate for loans referencing CDOR. Lenders and borrowers may want to consider the initial fallback rate for CDOR loans on a case-by-case basis rather than simply using the language published by CARR.

Additionally, where Term CORRA is used, CARR emphasizes that strong fallback language is required. Citing potential market liquidity challenges with the contracts underlying Term CORRA, CARR indicates that the administrator may have to amend the underlying methodology as needed. If the amendments are unsuccessful, the administrator may have to cease the publication of Term CORRA. In most instances, the fallback language associated with Term CORRA will reference overnight CORRA calculated in arrears. CARR also advises that users must ensure they have sufficient operational capacity to transact in their chosen fallback rates.

Conclusion

The development of Term CORRA will provide a forward-looking term rate that will ease the upcoming transition away from CDOR. However, since CARR has included multiple references to liquidity issues in their press releases announcing the development of Term CORRA, it remains to be seen if this new benchmark will be sustainable in the market.

[1] See CARR, "CARR announces development of a Term CORRA benchmark - Bank of Canada" (January 11, 2023). It should be noted that the Office of the Superintendent of Financial Institutions (Canada) ("**OSFI**") and

Canadian securities regulators have not yet commented on the acceptability of Term CORRA as a benchmark, though OSFI did mention the then-ongoing Term CORRA consultation by CARR in its Industry Letter of May 16, 2022 regarding expectations for CDOR Transition.

[2] See CARR, "Term CORRA Methodology – CARR Recommended Approach" (January 11, 2023).

[3] Pursuant to Multilateral Instrument 25-102 *Designated Benchmarks and Benchmark Administrators* any major change to the method of calculating Term CORRA would be subject to public consultation.

[4] See CARR, "The administration of Term CORRA" (January 11, 2023).

[5] See CARR, "CARR's approved use cases for Term CORRA" (January 11, 2023) [*Approved Use Cases*]

[6] While Term SOFR is not permitted to be used for inter-dealer derivative transactions, CARR identified this as being an issue for US banks in managing risk and that there is some demand for allowing Term SOFR to be used in inter-dealer derivative transactions.

[7] *Approved Use Cases*, *supra* note 5. CARR notes that the fallback rate for derivatives referencing CDOR and documented under standard ISDA terms is overnight CORRA rather than Term CORRA, therefore a CDOR loan hedged with a CDOR referencing derivative will be automatically converted to a derivative referencing overnight CORRA. This will result in a mismatch if the related loan falls back to Term CORRA and the hedge falls back to overnight CORRA.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.